COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WESTERN LEWIS RECTORVILLE FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	)	CASE NO. 92-331

O R D E R

On October 1, 1992, Western Lewis-Rectorville Water and Gas District ("WLR") filed its application for Commission approval of a proposed increase in its rates for gas service. Commission Staff, having performed a limited financial review of WLR's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding WLR's proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 6th day of April, 1993.

PUBLIC SERVICE COMMISSION

For the Commission

ATTEST:

Executive Director

COMMONWEALTH OF KENTUCKY

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STAFF REPORT

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STAFF REPORT

ON

WESTERN LEWIS RECTORVILLE GAS DISTRICT

CASE NO. 92-331

A. Preface

Western Lewis-Rectorville Water and Gas District ("Western Lewis") filed two separate applications for rate adjustments pursuant to 807 KAR 5:076, the Alternative Rate Filing Procedure for Small Utilities ("ARF"). The District's Water Division ("Water Division") filed Case No. 92-313.[1] The District's Gas Division ("Gas Division") filed Case No. 92-331. This report represents Staff analysis of the Gas Division. The rates proposed by the Gas Division in this case would generate approximately $53,961 in additional annual revenues or approximately 29 percent based on normalized test-year sales.

As part of its endeavor to shorten and simplify the regulatory process for utilities, the Commission chose to perform a financial review of Western Lewis for the test period, the 12-month period ending December 31, 1991. Tammy Page of the Commission's Financial Analysis Division conducted a financial review of the Gas Division and Mark Frost of the Commission's Financial Analysis Division conducted a financial review of the Water Division on October 21-22 & 30, 1992 at the office of James Smith, C.P.A., in Maysville, Kentucky. This report was prepared by Ms. Page, with the exception

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1 Case No. 92-313, The Application of Western Lewis-Rectorville Water and Gas District for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

of sections dealing with Normalized Revenues and Required Rates, which were prepared by Jordan C. Neel of the Commission's Rates and Research Division.

Scope

The scope of the review was limited to obtaining information to determine that the operating expenses as reported in the Gas District's application for the period ending December 31, 1991 were representative of normal operations, and to evaluate the pro forma adjustments proposed in its filing. Expenditures charged to test-year operations were reviewed, including any supporting invoices. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

In 1992, the Financial Audit Branch of the Commission's Financial Analysis Division performed an audit ("PSC Audit") of Western Lewis for the year ended December 31, 1990. After an extensive review, the PSC Audit Team ("Audit Team") determined that Western Lewis was not properly allocating expenses between the Gas and Water Divisions. Staff reviewed the PSC Audit allocations of expenses and the Gas Division's allocations for the test period. By reviewing these allocations, Staff determined a basis for the allocations proposed in this report.

B. Test-Year Restatements

The records supporting the financial statements contained in the Gas Division's application were the primary financial documents analyzed in this review. The account classifications used by the

Gas Division to record its transactions and compile its financial statements are generally in conformity with the Uniform System of Accounts ("USoA") for gas utilities. Staff has adopted the financial statements supplied by the Gas Division for the test period for rate-making purposes with the following modifications:

Gas Plant in Service

During the PSC Audit, the Audit Team determined that the amounts recorded in plant as meters and meter installations should be reduced by the amount of the gas connection fee paid by the customer receiving gas service. According to the USoA for natural gas companies, the plant accounts should not include the cost of plant contributed to the company. The Audit Team then determined that the amounts recorded in prior years as accumulated depreciation on the contributed plant should be charged to retained earnings. The adjustment was treated as a correction of an error since the utility was not accounting for contributions in accordance with industry practice.

During the field review, Staff became aware that a meter had been misclassified in the mains section. The cost of the meter should have been written off with the other accounts written off by the Audit Team. Staff recommends that the following entry be made and that it be treated as a correction of an error for the portion of the utility plant which is being reimbursed by the customers through the gas connection fee. The entry would be as follows:

Acct. No.			
108	Accumulated Depreciation - Meters	489.86	
216	Retained Earnings	178.14	
101	Utility Plant - Meters		668.00
	(Correction of an error of plant reimbursement)		

Accumulated Depreciation

During the PSC Audit, the Audit Team determined that Western Lewis was using a composite rate instead of a straight line rate. The Audit Team recommended to Western Lewis that it adopt the straight line depreciation method. Faud Sharifi of the Commission's Engineering Department reviewed the useful lives which were instituted and came to the conclusion that a portion of the rates were not consistent with what the Commission normally uses. Those sections of plant which were being depreciated over a 15 year period were changed to 20 years.

After consideration of all of these adjustments, Accumulated Depreciation should be reduced by a total of $6,201 and have a balance of $191,047 for the period ending December 31, 1991.

Depreciation Expense

Due to errors in the Utility Plant and Accumulated Depreciation accounts detailed in the preceding sections of this report, the test-year depreciation expense was also incorrect. As explained in the Accumulated Depreciation section, Staff reviewed the useful lives and Staff determined that the useful lives were not consistent with what the Commission normally uses. Staff utilized the new useful lives when determining the depreciation expense. As a result of Staff's analysis, test-year actual depreciation expense has been restated at $3,729 which is a reduction of $695 to the amount recorded by the Gas Division on the Income Statement. This adjustment has been included on Staff's restated Income Statement.

<u>Rents - Distribution</u>

In its application, the Gas Division had a balance of $4,767 for Account No. 760, Rents, in the Distribution expenses section. This amount was made up of rental expense for the building, rental equipment for the office, and office supplies. Of this amount, $4,658 should have been reported in Account No. 931, Rents, as a part of the Administrative and General expenses. The remainder $109, should have been reported in Account No. 921, Office Supplies and Expenses.

<u>Maintenance - Other</u>

Western Lewis reimburses employee Rick Hilterbrandt $550 monthly for the use of his truck for Western Lewis' repairs and maintenance. Total charges in this account for 1991 for the reimbursements were $4,400. Allocations between Gas and Water divisions for this expense are the same as the field labor wages, 80 percent to Water and 20 percent to Gas. Staff determined that the amount related to the Gas Division should be reclassified as a transportation expense. Therefore, Staff has determined that $880 should be reclassified as transportation expense.

Amortization

The Gas Division reported amortization expense of $292 for the test period. Per the annual report, the Gas Division recorded this expense in Account No. 405, "Amortization of Other Gas Plant". This expense is the amortized portion of a debt discount related to a bond issue. The discount is being amortized over 35 years at a rate of $292 annually. The unamortized discount at December 31,1991 is $2,925.13. This expense should be recorded in Account No. 428, "Amortization of Debt Discount and Expense". The Gas Division should correct this misclassification when filing its next annual report.

Office Supplies and Expenses

As explained in the Rents sections, $109 should have been reported in this account. These were expenses incurred for computer supplies that were included as a part of rental expense. As explained in the following section, there should be an additional amount of $6,048 to this account. This results in a balance of $8,477.

Mains and Services Supplies and Expenses

The Gas Division reported a balance of $10,044 for this account. This amount consisted of $6,048 for utilities and $3,996 for materials and supplies. Staff has determined that pursuant to the USoA, the utilities expense should have been reported in Account No. 921, "Office Supplies and Expenses". Therefore, Mains and Services Supplies and Expenses should be reduced by $6,048 and have a balance of $3,996.

These adjustments result in the following restated test-year Financial Statements:

Western Lewis-Rectorville Gas Division
Balance Sheet
For the Year Ended December 31, 1991

	Per Annual Report	Staff Adjustments	Staff Restated Test-Year
ASSETS AND OTHER DEBITS			
Utility Plant	$ 244,704	$ (668)	$ 244,036
Less: Acc. Depr.	(197,248)	6,201	(191,047)
Net Utility Plant	$ 47,456	$ 5,533	$ 52,989
Other Property & Investments	$ 3	$ 0	$ 3
Current & Accrued Assets			
Accounts Rec.	$ 30,784	$ 0	$ 30,784
Prepayments	1,193	0	1,193
Other Assets	10,834	0	10,834
Total Current & Accrued Assets	$ 42,814	$ 0	$ 42,814
Deferred Debits	$ 2,925	$ 0	$ 2,925
TOTAL ASSETS & OTHER DEBITS	$ 93,195	$ 5,533	$ 98,728
LIABILITIES AND OTHER CREDITS			
Proprietary Capital	$(227,630)	$ 5,533	$(222,097)
Long-Term Debt			
Bonds	79,205	0	79,205
Advances-Assoc.	20,700	$	$ 20,700
Total Long-Term Debt	$ 99,905	$ 0	$ 99,905
Current & Accrued Liabilities			
Notes Payable	$ 6,200	$ 0	$ 6,200
Accounts Payable	95,503	0	95,503
A/P - Assoc.	89,935	0	89,935
Customer Deposits	3,860	0	3,860
Taxes Accrued	8,711	0	8,711
Interest Accrued	10,177	0	$ 10,177
Total Current & Accrued Liab.	$ 214,386	$ 0	$ 214,386
Deferred Credits	$ 6,534	$ 0	$ 6,534
TOTAL LIABILITIES & OTHER CREDITS	$ 93,195	$ 5,533	$ 98,728

Western Lewis-Rectorville Gas Division
Income Statement
For the Year Ended December 31,1991

ACCOUNTS	Test-Year End Balances 12/31/91	Staff Test-Year Adjustments	Staff Restated Test-Year
Operating revenues:			
Gas Sales	$250,756	$ 0	$250,756
Other Revenues	32,021	0	32,021
Total Revenues	$282,777	$ 0	$282,777
Operating Expenses			
Natural Gas Purchases	$198,682	$ 0	$198,682
Distribution Exp.			
Mains & Service Labor	$ 10,684	$ 0	$ 10,684
Supplies	10,044	(6,048)	3,996
Rents	4,767	(4,767)	0
Maint - Lines	3,403	0	3,403
Maint - Meters	1,517	0	1,517
Maint - Other	2,775	(880)	1,895
Total Dist. Exp.	$ 33,190	$(11,695)	$ 21,495
Meter Reading Labor	$ 2,018	$ 0	$ 2,018
Adm. & Gen. Exp.			
Adm. Salaries	$ 21,813	$ 0	$ 21,813
Rents	0	4,658	4,658
Office Supplies	2,320	6,157	8,477
Outside Services	2,062	0	2,062
Insurance	2,644	0	2,644
Misc. Gen. Exp.	2,342	0	2,342
Transportation	0	$ 880	$ 880
Total Adm & Gen	$ 31,181	11,695	$ 42,876
Total Operating & Maintenance Exp.	$265,071	$ 0	$265,071
Depreciation	$ 4,424	$ (695)	$ 3,729
Amortization	292	0	292
Taxes, Other than Income	2,675	0	2,675

Total Operating Exp	$272,462	$ (695)	$271,767
Net Operating Income	$ 10,315	$ 695	$ 11,010
Interest on Long-Term Debt	$ 4,603	$ 0	$ 4,603
Non utility Deduc.	1,618	0	1,618
Other Int. Exp.	$ 645	$ 0	$ 645
Net Income	$ 3,449	$ 695	$ 4,144

C. Recommended Rate-Making Adjustments

Normalized Revenues from Sales

The Gas Division reported sales revenues to be $250,576 based on sales of 51,901 Mcf. Staff recommends a normalized sales revenue of $188,900 based on a billing analysis provided by the utility indicating a sales volume of 41,800 Mcf and based on retail rates in effect at the time the rate case was filed, as approved in Case No. 9642-ZZ.[2]

Purchased Gas Adjustment Clause

The most current purchased gas adjustment approved by the Commission for the Gas Division should be incorporated into the final retail rates.

Natural Gas Purchases

The Gas Division has reported an actual natural gas purchase expense for the test year of $198,682 based on purchases of 52,939 Mcf. An annual line loss of approximately 2 percent is indicated using the Gas Division's reported sales and purchase volumes. Staff recommends a normalized gas purchase expense of $141,658 based on allowable purchases of 42,636 Mcf and the supplier rate reported in Case No. 9642-ZZ.

Other Revenue Surcharge

The Gas Division proposed a reduction of $32,021 to this account to eliminate all revenues from the surcharge. A customer charge of $1.00 per month and a usage charge of $0.59 per Mcf was

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[2] Case No. 9642-ZZ, The Notice of Purchased Gas Adjustment Filing of Western Lewis-Rectorville Water and Gas District, Order dated August 11, 1992.

approved by the Commission in Case No. 9642[3] to permit the Gas Division to repay its past due gas purchases owed to Columbia Gas Transmission Corporation ("TCO"). The Commission estimated that the surcharge would produce approximately $39,636 in temporary annual surcharge revenues. It authorized the surcharge's assessment for a period not to exceed 60 months as of the February 4, 1987 Order. As of January 31, 1992, the Gas Division had collected $164,217.08 from the surcharge and remitted those proceeds to TCO. Since then, the time period for the surcharge has ended. The Gas Division does not seek an extension of the surcharge, but proposes a reduction of $32,021 to this account to eliminate all revenues from the surcharge for rate-making purposes. Staff believes this proposal is reasonable and recommends it be adopted for rate-making purposes.

Mains and Service Labor

The Gas Division proposed to increase the Mains and Service Labor account by $1,116. This represents an 11 percent increase for additional labor hours and wage increases for Mains and Service Labor. Staff has normalized wages for the test year which results in a total of $13,780 in Mains and Service Labor.

The Gas Division did not give its employees a pay raise in 1991, but did grant a $1 per hour wage increase in 1992, which

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[3] Case No. 9642, Western Lewis-Rectorville Water and Gas District Mason and Lewis Counties, Kentucky for a Revision of Gas Rates Application, Order dated February 4, 1987.

results in approximate increases in the range of 6 to 10 percent per year for each employee.

The Gas Division experienced an employee turn-over in the test period. Its current staff has gained experience and training that enables them to perform competently the required tasks. In order to maintain a continuity of service to its customers, it is important for the Gas Division to retain its current work-force.

In evaluating pro forma wage adjustments, Staff would not normally include a wage adjustment which occurs significantly beyond the end of the test period; however, due to the previously stated circumstances related to change in the work force, the adjustment based on the 1992 wage increase is acceptable in this instance.

On October 5, 1992, in Case No. 91-221,[4] Western Lewis filed with the Commission its plan to maintain complete and accurate records and proper allocation of its funds. It proposed to change the labor allocation between the Water and Gas Divisions. Beginning in 1992, Western Lewis allocated 20 percent of Mains and Service Labor to the Gas Division. The Field Labor allocation is based on a time study Western Lewis performed using the 1991 and 1992 daily time sheets. Staff is of the opinion that the proposed allocation is adequately documented, is reasonable and should be reflected in the Gas Division's test-period operations. Staff allocated the

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[4] Case No. 91-221, Alleged Failure to Comply with Commission Order From Case No. 9642 Issued February 4, 1987.

field labor and recommends that total wages for the Gas Division for the test period be decreased $3,267 which would result in total wages of $7,417 as shown in Appendix A.

Mains and Services Supplies and Expenses

The Gas Division proposed to increase Mains and Services Supplies and Expenses by $956 to purchase additional materials and parts. As explained in the restatements section, this account, after reclassifying, has a balance of $3,996. Western Lewis originally allocated 31 percent of this expense to the Gas Division. Western Lewis provided workpapers showing specific amounts. After reviewing the Division's workpapers, Staff determined that the actual test year level of expense should be $4,512, a difference of $516. This difference results from an improper allocation, thus, the amount which should have been charged to the Gas Division is greater than the amount reported. The Gas Division failed to provide sufficient evidence to support its proposed adjustment of $956. Therefore, Staff recommends that the proposed adjustment be denied. It also recommends that Mains and Services Supplies and Expenses be increased by $516, resulting in an adjusted test year expense of $4,512.

In a response to a Staff request dated November 5, 1992, the Gas Division provided additional information about the proposed test period adjustments. The Gas Division provided workpapers which demonstrate how certain amounts were specifically allocated.

The following accounts have been adjusted to reflect the proper allocations.

<u>Maintenance - Lines</u>. The Gas Division proposed an increase of $2,097 for mandatory inspection and testing of lines. Staff recommends that this adjustment be denied due to the fact that the Gas Division did not provide Staff with any supporting evidence for this adjustment. The Gas Division reported a test year level of expense of $3,403 for this account. After reviewing the expenditures, Staff determined that the actual test year level of expense should be $3,063. Western Lewis had originally allocated 50 percent of this expense to the Gas Division. In its response, Western Lewis provided workpapers showing specific amounts for this account, thus, the amounts which should have been charged to the Gas Division are less than the amount reported. Staff recommends that Maintenance - Lines be decreased by $340 which results in an adjusted level of expense of $3,063.

<u>Maintenance - Meters</u>. The Gas Division proposed to increase the Maintenance - Meters account by $5,283. This adjustment represents the estimated average cost to perform scheduled maintenance on 10 percent of the meters in place. KAR 807 5:022, Section 8(5) requires periodic meter testing. Staff recognizes that the Gas Division must perform scheduled maintenance annually on 10 percent of its meters in place.

The Gas Division reported a test year expense level of $1,517. Western Lewis was allocating 31 percent of this account to the Gas

Division. Staff reviewed the expenditures and workpapers and determined that the amounts for the Maintenance - Meters account for the Gas Division should have had an actual test year expense of $1,711. Western Lewis improperly allocated this account to the Gas Division, thus, the amounts which should have been charged to the Gas Division are greater than the amounts reported.

After consideration of these adjustments, Maintenance -Meters should be increased by $5,477,resulting in an adjusted expense level of $6,994.

Maintenance - Other. The Gas Division proposed an increase of $225 to reflect the increased costs of maintenance parts other than lines or meters, such as regulators. It however failed to provide adequate evidence to support this adjustment.

The Gas Division reported an expense level of $2,775. As explained in a prior section, Maintenance - Other has a restated test year expense level of $1,895.

During the field review, Western Lewis stated that 31 percent of this account was allocated to the Gas Division. Staff reviewed the expenditures and workpapers and determined that the actual test year expense should be $2,713. The difference is due to improper allocation. Staff did not allocate, but charged specific amounts to Maintenance - Other. Staff recommends that Maintenance - Other be increase by $818, resulting in an expense level of $2,713.

<u>Meter Reading Labor</u>

An increase of $382 was proposed by the Gas Division for this account due to a fixed monthly fee of $500 being implemented. Western Lewis pays its meter reader a fee of $500 per month or $6,000 annually, which is allocated 50 percent to the Gas Division. In the 1990 PSC Audit, the Audit Team allocated meter reading labor expense based on the following 2 part customer ratio: (1) the number of customers with combined water and gas service; and (2) the number of customers with gas or water service alone.

Given that not all of the Gas Division's customers have water service, Staff is of the opinion that the customer ratio allocation better reflects the meter reading cost incurred by both divisions. Based on this method, the Gas Division is allocated 30 percent or $1,800 of the meter reading labor, as shown in Appendix B.

<u>Administrative and General</u>

The Gas Division proposed an increase of $1,119 in Administrative and General expenses. As explained in the application, this represents a 3 percent increase over 1991 for general cost increases. Staff's analysis of each account follows:

<u>Salaries</u>. The Gas Division proposed an increase of $87 to salaries. During the test-period, the Gas Division employed an office manager, office clerk, maintenance supervisor, and one full-time and various part-time maintenance employees. In the first quarter of 1991, the Gas Division replaced its office manager and

some employees and in 1992 the Gas Division eliminated its part-time positions.

In evaluating pro forma wage adjustments, Staff would not normally include a wage adjustment which occurs significantly beyond the end of the test period; however, due to the previously stated circumstances as explained in the Mains and Service Labor section, the adjustment based on the 1992 wage increase is acceptable in this instance. After analyzing and weighing all of the factors, Staff is of the opinion that the wage increases granted in 1992 are reasonable.

In the plan filed by Western Lewis in Case No. 91-221, Western Lewis proposed to change the allocations between the Gas and Water Divisions' payroll. Beginning in 1992, Western Lewis allocated 37 percent of office salaries to the Gas Division. The office salary allocation was based on inquiry and observation of the 2 office employees. Western Lewis stated that no study was otherwise performed and it felt that in consideration of only two office employees, the division of costs by customer number appeared proper.

Staff is of the opinion that the Gas Division has failed to document this allocation and therefore, the allocation should remain the same at 50 percent as was done during the test year. Staff recommends that Administrative and General Salaries be increased by $732 to reflect the 50 percent allocation which results in total Administrative and General Salaries of $21,208 as shown in Appendix A.

The Gas Division reported Officers' and Directors' Fees of $1,337 in Administrative and General Salaries. According to the USoA, these fees are to be reported in Account No. 930.2, "Miscellaneous General Expenses". Staff has not reclassified these fees for purposes of this report; however, both of these accounts, Administrative & General Salaries and Miscellaneous General Expenses are considered to be Administrative and General Expenses. The moving of this amount from one account to another would not effect the net income as reported in the annual report. Staff recommends that the Gas Division separate these accounts in future financial statements.

The Gas Division reported test-period Officers' and Directors' Fees and Expenses of $1,337, which reflects a 50 percent allocation of the fees and expenses to the Gas Division. Each of the 4 commissioners are paid an annual fee of $200 for a total annual expense of $800. The difference, $937, consists of per diem expenses for travel which the Commission does not normally allow. Staff recommends that this expense be reduced by $937, resulting in a test year expense of $800.

Rents. The Gas Division reported a year end expense level of $4,767 before Staff restated this account. This expense consisted of office rent, three equipment rental contracts, and various office supplies. As explained in a prior section, Staff restated this account to reflect a test year expense level of $4,658.

During the test year, Western Lewis relocated its office, reducing its office rent from $400 to $250 per month. Also during the test year, Western Lewis completed its contract for office equipment. Staff annualized the rental expenses and determined that rent expense for Western Lewis should be $4,660.[5] In the test period, Western Lewis allocated 50 percent of this expense to the Gas Division. Staff agrees with this allocation, which results in a rent expense of $2,330[6] for the Gas Division. Staff recommends that rent expense be decreased $2,327, resulting in a test year expense level of $2,330.

Office Supplies. The Gas Division proposed to increase the Office Supplies account by $280. In its application, Western Lewis stated that Office Supplies were allocated 50 percent to the Gas Division. Western Lewis subsequently proposed to allocate only 37 percent of its expense to the Gas Division. After reviewing, Staff concluded that Western Lewis did not adequately document the 37 percent allocation and therefore, the allocation to the Gas Division should remain the same as used during the test year.

5	Office rent	$250 x 12 =	$3,000
	Xerox copier	92 x 12 =	1,104
	Microage Computer	-	556
			$4,660

6 $4,660 ÷ 50% = $2,330.

As explained in the restatement section, the Gas Division should have reported a balance of $8,477 in this account. This consists of a reported test year expense of $2,320 with reclassifications of $109 of computer supplies and $6,048 of utility expense to office supplies.

Western Lewis reported a total expense level of $1,702 for office utilities, $2,606 for postage, and $3,482 for office supplies. The office supplies expense consists of $371 for continued education relating to the operations, $2,231 of general office supplies, $176 for Kentucky Rural Water Association Dues, and $704 of operating expenses. Staff recommends, with the exception of the Kentucky Rural Water Association Dues, 50 percent of these expenses should be allocated to the Gas Division. None of the Kentucky Rural Water Association Dues expense should be allocated to the Gas Division. Therefore, the Office Supplies expense of $3,807 should consist of $851 for utilities, $1,303 for postage, and $1,653 for office supplies. Staff recommends that the Office Supplies test-year expense level of $8,477 be reduced $4,670 for a test year expense level of $3,807.

<u>Outside Services</u>. The Gas Division proposed an increase of $138 for increased costs in audit and legal services and other contracted services. The Gas Division reported $2,062 as a test year expense level. This amount consists of $1,159 for outside services and $903 for contract labor. Staff has verified the amount for contract labor and recommends its acceptance.

During the field review, Staff reviewed the expenditures and determined that the actual test year expense for outside services is $650. The difference is due to improper allocation between the two divisions. The Gas Division failed to provide any information to substantiate the proposed increase. Staff, therefore, recommends that this adjustment not be accepted. Staff recommends that Outside Services should have a total test year expense level of $1,553. Therefore, Staff recommends that this account be reduced $509 to reflect the test year level of $1,553.

Insurance. The Gas Division proposed an increase of $156 to insurance expense to provide for an increase in insurance premiums. In the test period, the Gas Division was allocated 50 percent of the insurance expense. Upon review of the invoices, Staff recognized that the annual insurance premiums had increased to $7,534. Staff recommends that the increased cost be reflected in adjusted test-period operations.

A 50 percent allocation of the 1992 premiums of $7,534 would result in an insurance expense of $3,767. Therefore, insurance expense of $2,644 has been increased by $1,123.

Transportation. Since Western Lewis does not own a vehicle, its maintenance supervisor used his own vehicle in the test-period and was reimbursed $550 per month or $6,600 annually. Western Lewis did not present cost justification, (i.e., business vs. personal truck usage, and the basis for determining that $550 is a reasonable cost) for these reimbursements, nor could Staff find justification in the financial records. Absent this cost justification, Staff is unable to form an opinion as to the reasonableness of the reimbursement level, and therefore, recommends that this cost not be included in the adjusted test period operations.

Miscellaneous General Expense. The Gas Division proposed an increase of $458 to Miscellaneous General Expense. This account is composed of uncollectibles and the telephone expense. The Gas Division did not provide adequate support for this adjustment, therefore, Staff recommends that the proposed increase of $458 be denied. Based on its review of the invoices, Staff has concluded that many of these telephone expenses were installation charges incurred when Western Lewis relocated its office, and the cost of a beeper. Since these costs are non-recurring Staff recommends their removal from test-period operations for rate-making purposes. Staff proposes to decrease this account by $136 which results in a balance of $2,206.

Depreciation

As was previously discussed, the Audit Team determined that the depreciation expense on the utility plant was being computed by the Division using a composite rate method. While the composite rate method complies with generally accepted accounting principles, the Commission has previously required the use of straight-line depreciation for utility reporting purposes because it is considered the most reasonable means of allocating investment costs over generations of ratepayers.

The Gas Division proposed an increase of $126 to test year depreciation expense. Staff reviewed the depreciation records and recommends the following adjustments. First, Faud Sharifi of the Commission's Engineering Department stated that useful lives for a portion of the utility plant were not consistent with what the Commission normally uses, as shown in the table below:

Utility Plant	Gas Division's Useful Lives	Staff's Useful Lives
General Plant	25	25
Measuring & Regulator Station Equipment	15	20
Mains	40	40
Services	15	20
Meters	15	20
House Regulators	15	20
House Regulator Installation	15	20
Office Furniture	5	5
Tools	10	10
Communication	5	5

Staff adjusted depreciation expense to reflect the useful lives which the Commission normally uses. Second, the Gas Division purchased cathodic protection equipment in September 1991. Staff annualized the depreciation expense to reflect this purchase. Therefore, Staff recommends for rate-making purposes that depreciation expense be increased $729 to result in a balance of $4,458 as shown in Appendix C.

Rate Case Expenses

The Gas Division did not propose an adjustment for rate case expense in its application. At the time of the field review, the actual cost incurred to file this case and Case No. 92-313 was $1,613. Staff has calculated rate case expense of $269 based on amortizing rate case cost of $1,613 over a 3-year period and allocating 50 percent of the expense to the Gas Division. Staff recommends that $269 be included in the Gas Division's test-period operations.

Taxes, Other Than Income

Included in this account are the payroll taxes and the test-year PSC Assessment. The Gas Division proposed an increase of $275 to this account based on the proposed wage increase. After calculating field labor and administrative salaries, Staff determined that the payroll taxes should be increased by $92 which results in a balance of $2,190 for payroll taxes.

Interest on Long-Term Debt

The Gas Division recorded $4,603 of interest expense during the test year. The expense includes interest on revenue bonds. The Gas Division proposed to decrease this expense by $340.

The outstanding balance of the revenue bonds is $79,205 with an interest rate of 5 1/2 percent. This would result in annual interest expense of $4,356. Staff has determined that interest expense should be decreased by $247 to reflect the decrease in principal.

Other Interest Expense

The Gas Division proposes an increase of $1,412 which reflects interest costs on unpaid accounts, including Columbia Gas and cathodic protection equipment. In its application and annual report, the Gas Division reported $2,263 for Other Interest Expense. This amount consisted of penalties of $1,618 and $645 of interest expense. Actual expenses incurred in 1992 for this expense included $2,752.79 for past due purchases to Columbia Gas and $1,946.30 for interest on cathodic protection equipment. Actual Other Interest Expense for the test period was $4,699.09. Columbia Gas is calculating interest charges on past due receivables at a rate of 6.17 percent - 6.50 percent per year. Staff has determined that the Gas Division is about a month behind on payments to Columbia Gas which results in additional costs which could be avoided if the bills were paid timely. The Gas Division has the responsibility, if it cannot pay current operating expenses, to timely file a rate case with the Commission. The rate increase in this case should provide adequate revenue to enable the Gas Division to make timely payments. Therefore, Staff recommends that interest expense of $2,752.79 on the Columbia Gas account be excluded for rate-making purposes.

The Gas Division signed a contract for the cathodic protection equipment in which a 1 percent service charge is imposed every month on the unpaid balance of $15,758. Staff has determined the total annual interest charges if the Gas Division continues paying the required amount of $500 per month for the test period. Staff took the total debt of $15,758 and deducted $500 for each month and determined the service charge for each month separately. Total annual interest charges on the debt would be $1,659 as shown in Appendix D. Staff recommends that this be accepted for rate-making purposes.

Based on the recommendations proposed in this Staff Report, the Gas Division's adjusted operations are as follows:

Accounts	Staff Restated Test-Year	Staff Proposed Adjustments	Staff Adjusted Balances
Operating Revenues:			
Gas Sales	$ 250,756	$ (61,856)	$ 188,900
Other Revenues	32,021	(32,021)	0
Total Operating Revenue	$ 282,777	$ (93,877)	$ 188,900
Operating Expenses:			
Natural Gas Purchases	$ 198,682	$ (57,024)	$ 141,658
Distribution Exp:			
Mains & Ser. Labor	$ 10,684	$ (3,267)	$ 7,417
Supplies	3,996	516	4,512
Rents	0	0	0
Maint - Lines	3,403	(340)	3,063
Maint - Meters	1,517	5,477	6,994
Maint - Other	1,895	818	2,713
Total Dist. Exp.	$ 21,495	$ 3,204	$ 24,699
Meter Reading Labor	$ 2,018	$ (218)	$ 1,800
Adm. & Gen. Exp.			
Salaries	$ 20,476	$ 732	$ 21,208
Commissioners' Fees	1,337	(937)	400
Office Supplies	8,477	(4,670)	3,807
Outside Services	2,062	(509)	1,553
Rents	4,658	(2,327)	2,331
Insurance	2,644	1,123	3,767
Transportation	880	(880)	0
Misc. Gen. Exp.	2,342	(136)	2,206

Reg. Comm. Exp.	0	269	269
Total Adm. & Gen. Exp.	$ 42,876	$ (7,335)	$ 35,541
Total Operating & Maint. Exp.	$ 265,071	$ (61,373)	$ 203,698
Depreciation	$ 3,729	$ 729	$ 4,458
Amortization	292	0	292
Taxes Other Income Tax	2,675	92	2,767
Total Operating Exp.	$ 271,767	$ (60,552)	$ 211,215
Net Operating Income	$ 11,010	$ (33,325)	$ (22,315)
Other Deductions:			
Interest on Long-Term	$ 4,603	$ 0	$ 4,603
Other Int. Exp.	2,263	(604)	1,659
Total Other Deductions	$ 6,866	$ (604)	$ 6,262
Net Income	$ 4,144	$ (32,721)	$ (28,577)

D. Revenue Requirements

The approach frequently used by this Commission to determine the allowable earnings for "non profit" gas districts is Debt Service Coverage ("DSC"). Staff recommends the use of this approach in determining the Gas Division's revenue requirement.

Staff has determined that the Gas Division's annual debt service is $10,298.[7] The Gas Division's adjusted operations reflect ($22,315) in income available for debt service which

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	Interest	Principal	1964 Bond Issuance
1993	$3,922	$6,200	$10,122
1994	3,581	6,200	9,781
1995	3,240	7,750	10,990
	Total 3-Year Payments		$30,893
	3-Year Average Debt Service		$10,298

results in a DSC of (2.17)x.[8] The increase in rates of $53,961 requested by the Gas Division would result in income available for debt service of $31,646[9] and a DSC of 3.07x.[10]

Staff is of the opinion that a 1.2x DSC will provide sufficient revenues to allow the Gas Division to meet its operating expenses and service its debt. A DSC of 1.2x will result in a revenue requirement of $225,232[11] and therefore, Staff recommends that the Gas Division be granted an increase in annual revenues from rates of $36,332.[12]

Retail Rates

The Gas Division did not propose any change in the retail rate design or to the monthly customer charge. Staff recommends that no change be made to rate design or to the monthly customer charge and that the increase in revenue be allocated based on Mcf consumption.

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8 $(22,315) + 10,298 = (2.17)x.

9 $(22,315) + 53,961 = $31,646.

10 [$(22,315) + 53,961] + 10,298 = 3.07x.

11

Debt Service	$ 10,298
Times: Recommended Coverage	x 1.2
Net Operating Income	$ 12,358
Add: Adjusted Operating Expenses	211,215
Subtotal	$ 223,573
Add: Other Interest Expense	$ 1,659
Revenue Requirement	$ 225,232
Less: Normalized Operating Revenues	(188,900)

12 Revenue Increase $36,332

Staff recommends the following retail rates for all customers, commercial and residential:

Customer Charge	$1.00 Per Month
First 1,000 cu. ft. or less	7.3108 (Minimum Bill)
Next 4,000 cu. ft. per 1,000 cu. ft.	4.7790
Next 5,000 cu. ft. per 1,000 cu. ft.	4.7195
Over 10,000 cu. ft. per 1,000 cu. ft.	4.5453

These rates will generate approximately a 17.6 percent increase in revenue for the Gas Division.

E. Signatures

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